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(916) 445-3723

June 8, 1988

Re:

Dear Mr.

This is in response to your letter of May 31, 1988.

We understand that your client, will be acquiring or has already acquired a Roll-on/Roll-off vessel from a foreign affiliate for approximately \$10 million. The vessel will be refurbished to comply with United States Coast Guard standards for such vessels. The refurbishing work will cost approximately \$3 million, of which approximately two-thirds will be labor and the remainder miscellaneous material and equipment. It is anticipated that the work will be performed in San Diego commencing on or about June 5, 1988. Work must be completed and charter service commenced no later than September 15, 1988.

Upon completion of the refurbishing the vessel will be registered and documented under the United States flag. The vessel will then be time chartered to the United States Navy for an initial period of 17 months, with two additional 17-month option periods. The charter hire paid by the Navy will average \$16,600 per diem over the total contract. Approximately half the per diem charter hire represents the capital cost of the vessel and the other half represents labor and incidental costs.

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The vessel will operate in what is called Combined Services Management Service. The primary mission will be to provide transportation and stowage of general breakbulk cargo, vehicles, ammunition, refrigerated and dry TEU containers for the Department of Defense. The vessel will not be assigned to the a home port per se, but rather will carry cargo from the West Coasts of the United States to the mid-Pacific islands and Far East ports. Itineraries include Midway and Wake Islands and other areas where there is little or no commercial transportation service. The contractual trading limits are worldwide and the Navy may change the itinerary to include shuttle service between foreign ports and also include Mediterranean and European ports. The vessel will not be used in any coastwide trade within the United States.

We are in agreement with this analysis that your client's purchase of the vessel qualifies for exemption, pursuant to Revenue and Taxation Code Section 6368, as a watercraft for use in interstate or foreign commerce involving the transportation of property for hire. Tax will not apply to the sale of the watercraft nor will tax apply to any sales of tangible personal property becoming a component part of the watercraft in the course of constructing, altering or improving the same.

Likewise, the time charter agreement is not subject to tax. The time charter is a contract to affreightment. It is a service contract, not a contract for the lease of tangible personal property. Even if this were a bareboat charter (a lease of tangible personal property), it would remain without tax consequence since the vessel constitutes mobile transportation equipment under Revenue and Taxation Code Section 6023. A lease of mobile transportation equipment is not a sale.

Very truly yours,

Gary J. Jugum
Assistant Chief Counsel

GJJ:sr